



States of Guernsey
Finance Sector
Development

CONSULTATION ON PROPOSED CHANGES TO THE GUERNSEY BANKING DEPOSIT COMPENSATION SCHEME (BAILIWICK OF GUERNSEY) ORDINANCE, 2008

Purpose and Type of Consultation

This consultation paper is being issued to seek feedback from business, stakeholders, consumers, industry associations, practitioners and any other interested parties on proposed changes to the Banking Deposit Compensation Scheme (Bailiwick of Guernsey) Ordinance, 2008 (the “**Ordinance**”) to assist the Guernsey Banking Deposit Compensation Scheme (the “**Scheme**”) to comply with certain of the core principles issued by the International Association of Deposit Insurers (“**IADI**”).

Finance Sector Development (“**FSD**”) is seeking feedback, comments and suggestions on the proposals to:-

1. amend the Ordinance to clarify the terms under which the Scheme may make partial payments of compensation;
2. amend section 18(4)(a) of the Ordinance and increase the potential aggregate maximum amount paid by a participant¹ in any calendar year from **£1,000,000** to **£2,000,000**;
3. remove section 18(4)(b) of the Ordinance, this being the limitation of 50% of a participant’s profits over the previous 3 years, in respect of the amount a participant may be required to pay, to the Scheme, in any calendar year;
4. amend sections 7, 8 and 13 of the Ordinance to allow for negative interest rates;
5. amend the Ordinance to clarify terms for the provision of data by participants to the Scheme; and
6. amend the Ordinance so that the compensation levies ² are payable within two (2) days of receipt of the relevant notice;
7. amend section 9 the Ordinance to require the Guernsey Financial Services Commission to issue a declaration of default, in respect of a bank, directly after it becomes aware of the same.

Together the above are referred to, in this consultation paper, as the “**Proposals**”.

The intention is that responses will be considered by the Committee *for* Economic Development (the “**Committee**”), which will in turn produce recommendations in respect of the Proposals.

Closing date: **16th June 2017**.

¹ See section 2 of the Ordinance.

² See section 18 of the Ordinance.

The Committee:-

1. would like to invite comments from all interested stakeholders, financial services businesses, customers and consumers about the Proposals; and
2. aims to work closely with stakeholders and industry to ensure the Bailiwick adopts the most appropriate changes to protect and enhance its economy and to support the financial services industry.

This consultation paper is a working document and does not prejudice any final decision to be made by the Committee.

Please refer to section 3 “responding to this consultation” for full details of how to respond to this consultation paper.

Executive Summary

The Scheme was created in 2008, pursuant to the Ordinance, at the height of the Global Financial Crisis³. All banks licensed, in the Bailiwick of Guernsey, by the Guernsey Financial Services Commission (the “**Commission**”) are participants in the Scheme. The Scheme provides compensation, when a participant fails, as follows:

- (i) it covers deposits by individual retail depositors, and some other limited categories of depositor such as Retirement Annuity Trusts, registered charities and accounts held for the benefit of children;
- (ii) it provides compensation of up to £50,000 (or equivalent in a foreign currency) to qualifying claimants⁴;
- (iii) compensation is payable within three (3) months of a bank failure (or receipt of a valid claim, if later)⁵; and
- (iv) total compensation is capped at £100,000,000 in any five (5) year period. If claims exceed this cap, compensation will be reduced on a pro rata basis.

The Scheme board (the “**Board**”), in conjunction with the schemes in the other Crown Dependencies, has been reviewing the new core principles issued by IADI, in November 2014, (the “**Core Principles**”) and is now considering amendments to its funding arrangements in conjunction with other changes to its operations. These changes will need to be effected, in part, via amendments to the Ordinance and this consultation paper seeks comments and views in respect of those proposed amendments.

The consultation closes on 16th June 2017.

³ See Billet D’Etat XIX 2008, 26th November 2008.

⁴ See section 12 of the Ordinance.

⁵ Subject to the limitations set out in Sections 15(2) and (3) of the Ordinance.

1. Background

1. Introduction

The Board has been reviewing the operation of the Scheme in the light of the Core Principles. The Core Principles are not mandatory, but they do represent the views of a major international body and compliance with them, to the greatest extent possible, will stand the Bailiwick in good stead in future international reviews of the finance sector by parties such as the IMF. The Core Principles represent best practice and the Committee is of the view that the major areas of non-compliance should be addressed as a priority. It should be noted that some aspects, such as bank resolution mechanisms, are outside the scope of the Scheme, but are being separately addressed.

The Committee is of the view that an immediate priority is the Scheme's lack of compliance with Core Principle 9 relating to liquidity. In simple terms this requires the availability of funds and funding mechanisms to ensure the prompt reimbursement of depositors' claims.

In this regard the concern is that, while the Scheme is entitled to recover the full cost of compensating depositors from the participants by means of levies, the Ordinance⁶ restricts the amount that can be levied in any one year on any one participant. To the extent that this restriction is fully applied, then the Scheme's ability to fund compensation would be materially impacted unless third party funding can be obtained.

In real terms some delay in making payments, whilst not desirable, may be acceptable though the Committee is concerned as to the prejudice which small depositors may experience. In addition, the Committee is further concerned that the potential funding shortfall is exacerbated by the fall in the number of participants, licensed by the Commission, contributing to the funding of the Scheme.

The Board is currently in discussions with the Committee, and the Policy & Resources Committee, in respect of a short term facility to address the potential funding shortfall.

The Committee proposes an approach which aims to balance the interests of the three primary stakeholders in respect of the Scheme: (i) potential future claimants, (ii) the licensed banks and (iii) the States of Guernsey as a potential funding entity.

2. Future claimants

The Board intends to use its discretion, under the Ordinance, to pay out initial compensation of a sum up to £10,000 (the "Initial Payment") and to pay the balance as soon as practicable thereafter. This is structured so as to benefit the smaller depositor, who is likely to be most directly impacted by any future participant default.

⁶ See section 18 of the Ordinance.

3. The Banks

The Proposals are aimed both at reducing the restrictions on the amounts that can be recovered through the compensation levy⁷ and on speeding up the payment process. It is envisaged that this augmentation, of the payment process, will not impose any significant additional costs on the banks.

4. The States

The Board will only be seeking funding on a committed basis for the potential maximum shortfall in respect of the Initial Payment envisaged above.

The overall outcome of the Proposals (and the above) is that the Scheme will be fully funded in respect of the Initial Payment within a short period of time, from the occurrence of a participant's default, in accordance with the terms of the Ordinance. The Scheme will be able to respond to compensation claims promptly, subject only to any processing delays, thus ensuring compliance with Core Principle 9.

It should be noted that in the event a participant is declared to be in default⁸, then the Board has twenty one (21) days to make claim forms available to depositors⁹ and a further three (3) months to make actual payment from the date of receipt of a valid claim¹⁰. This grants the Scheme a window of approximately four (4) months to make payment. The Board believes that the Initial Payment should be effected in a significantly shorter period of time. The Core Principles suggest that slow payment not only implies hardship to a depositor, but may also cause reputational issues for the Scheme itself. The new arrangements should allow initial compensation to be paid earlier, and, more importantly, are aimed at reassuring depositors that funding for such payments is available with the minimum of delay.

In addition to the above, the Core Principles state that deposit compensation schemes should move towards payment of compensation within seven (7) working days of a default. This is a demanding target, and one which many much larger schemes are not able to comply with.

The Board is currently considering how it should respond to this target, but in the interim it is suggesting a modification to the Ordinance to clarify issues regarding data collection which would be needed to research (and possibly implement) the same.

⁷ See section 8 of the Ordinance.

⁸ See section 9 of the Ordinance.

⁹ See section 10 of the Ordinance.

¹⁰ See section 15 of the Ordinance.

2. The Proposed Amendments

1 The effecting of payments to qualifying complainants.

The Scheme's ability to defer payment of compensation is set out in section 15 of the Ordinance. The Committee is of the opinion that this section be modified to clarify that payment may be deferred under a slightly wider set of circumstances and more specifically that a 'portion' of compensation, as referred to in the section, includes the ability to pay differing percentages of compensation to different claimants. This would be the effect of the initial payment of up to £10,000, referred to on page 5 of this consultation paper, which is intended to assist those likely to be most affected by a default.

Whilst the Ordinance does permit the Scheme to make an interim payment and a balancing payment it does not identify a specific amount. The Ordinance currently only expressly specifies the maximum amount which can be paid to a qualifying complainant¹¹.

Question 1

Do you believe that these modifications are appropriate? If your response is no, please explain why.

2 Modifying the payment caps

In respect of any five (5) year period the maximum payment, of £100,000,000, is funded on the following basis:-

- (i) £10,000,000 which is levied on all participants equally (the "**Primary Levy**"); and
- (ii) £90,000,000 which is also levied on all participants (the "**Secondary Levy**"), but is apportioned between such participants according to a formula set out in the Banking Deposit Compensation Scheme (Liability of Participants to Compensation Levy) (Bailiwick of Guernsey) Regulations, 2010 (the "**Regulations**").

While the maximum the Scheme can claim, in respect of the Secondary Levy is £90,000,000 this, in turn, is limited by a restriction in the Ordinance which caps a participant's payment obligation in any calendar year to a maximum of £1,000,000 or, if less, 50% of its average profits for the previous three (3) years¹². At the date of this consultation paper, there are currently twenty four (24) banks in the Scheme which is a material restriction on the amount which can be collected pursuant to the Secondary Levy.

¹¹ See section 12(2) of the Ordinance.

¹² See section 18(4) of the Ordinance.

It should be noted that the cap does not reduce the liability of a participant to pay the Secondary Levy. It merely permits the Secondary Levy to be paid by installments. Interest will apply to any deferred payment at two per cent. (2%) above base rate. Under these circumstances, on the assumption that participants should be able to borrow at or around the base rate, it is generally in their interest to pay promptly, even if they have no obligation to do so.

The Committee is of the view that the:-

- (i) £1,000,000 cap should be increased to £2,000,000 to ease funding pressure on the Scheme; and
- (ii) profits cap should be removed in its entirety. The fact that a participant is unprofitable domestically should not restrict its duty to fund the Scheme¹³.

Question 2

Do you believe that it is appropriate to increase the £1,000,000 cap to £2,000,000? If your response is no, please explain why.

Question 3

Do you believe that the “three years profits cap” should be removed? If your response is no, please explain why.

3 Negative interest rates

When the Ordinance was enacted, negative interest rates were not being applied in the banking sector. In recent times they have become more common. It has been identified that the Ordinance does not legislate for this possibility, and that in some circumstances depositors could be paid more than their account was worth, at the expense of the participant banks. It is proposed that the Ordinance be amended to remove this anomaly. The Committee is also of the opinion that the Ordinance requires amending to allow the Scheme, if subject to a negative interest charge, to deduct the same from the Scheme’s administration or compensation funds where appropriate.

Question 4

¹³ The profits cap is no longer considered appropriate particularly where banks are, more commonly, parts of larger international groups which are often profitable where domestic subsidiaries or branches are not.

Do you believe that it is appropriate to amend the Ordinance to legislate for negative interest rates and protect against possible adverse effects upon participant banks and/or the Scheme? If your response is no, please explain why.

4 Clarification of the obligations of participant banks in respect of data provision

Section 20 of the Ordinance currently requires data disclosure by a participant to the Scheme. While this section of the Ordinance is wide in scope, the Committee feels that it does not clarify that such data may include personal data on account holders (and thus data subject to the provisions of the Data Protection (Bailiwick of Guernsey) Law, 2001), nor that such data should be provided promptly. In anticipation of the possibility of a seven (7) day payment profile, as recommended by IADI, a clear obligation on participants to provide depositor data must be present.

Question 5

Do you agree that the Ordinance should be amended to include specific reference to personal data together with an obligation on participants to provide such data promptly to the Scheme. If your response is no, please explain why.

5 Alteration of the banks' payment period

The Primary Levy, is payable in equal shares by all participants. It is currently payable, in accordance with the terms of the Ordinance¹⁴, on a date set by the Scheme which may “not be later than 14 days” after the issue, by the Scheme, of the required notice. It is proposed that the Ordinance be amended to require that the Primary Levy be payable within three (3) working days of the issue of the notice. Allowing one day for delivery of a notice, this implies a two (2) day payment window for the Primary Levy and the Scheme being in receipt of these funds within three (3) working days of a participant going into default. The Committee does not expect any participant to have any difficulty in effecting payment within this timeframe.

Question 6

Do you believe it is appropriate to amend the Ordinance to specifically state that payment must be made within three (3) working days of the issue of the Primary Levy notice? If your response is no, please explain why.

The amounts payable by each participant in respect of the Secondary Levy are calculated via a formula (in the Regulations) which is expressed, in general terms, as a proportion of the deposits held by the relevant participant against the total deposits held by all participants.

¹⁴ As per Section 18(7)(c) of the Ordinance.

The timing, in respect of payment of the Secondary Levy, has a restriction such that the Board cannot request payment earlier than fourteen (14) days after the date of the notice (effectively providing a minimum two (2) week grace period, in addition to any implicit grace period while the sums due are calculated).

The “grace period” means that there is a mandatory delay estimated to be a minimum of seventeen (17) days before the Scheme would be in receipt of all amounts due pursuant to the Levies. The Committee is of the opinion that such a grace period is not required particularly when viewed in the context of the cap on the maximum payment required pursuant to the Secondary Levy.

The Committee is seeking to remove the grace period and require payments pursuant to the Secondary Levy to be effected, as with the Primary Levy, within three (3) working days of the issue of the relevant notice. The Committee does not expect any participant to have difficulty in effecting payment within this timeframe.

Question 7

Do you believe it is appropriate to amend the Ordinance to remove the “grace period” and to specifically state that payment must be made within three (3) working days of the issue of the Secondary Levy notice? If your response is no, please explain why.

6 Notice period for a declaration of default

Section 9 of the Ordinance gives the Commission up to twenty one (21) days to issue a declaration of default, even though the issues that might trigger such a default are likely to be known to the Commission well within this time period. While it is not suggested that the Commission would intentionally delay the issuing of any such declaration, the Board is of the view that there is no practical reason for the maintenance of such a large notice period. Furthermore such a delay could severely restrict the Scheme’s ability to respond to a participant’s default which was in the public domain. The Board has suggested, and the Committee supports the suggestion that the Ordinance be amended to make the Commission’s obligation to declare a default an immediate one, subject to the Commission being aware of the relevant triggering event.

Question 8

Do you believe it is appropriate to permit the Ordinance to be amended to require the Commission to declare a default immediately it becomes aware of a triggering event? If your response is no, please explain why.

3. Responding to the Consultation

Please provide your comments by 16th June 2016, in writing and preferably in a format that can be read by Microsoft Word. FSD requests responses to be made by email to the following address:

Electronic Copies

The easiest way to respond to this consultation paper is to complete the on-line questionnaire at <https://www.surveymonkey.co.uk/r/depositcompensationscheme>.

Email Responses

Email responses can be sent to: FinanceSectorDevelopment@gov.gg.

Hard Copies

Hard copies can be posted to:

Consultation on proposed changes to the Guernsey Banking Deposit Compensation (Bailiwick of Guernsey) Ordinance, 2008

Attention: Finance Sector Development
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The consultation closes on 16th June 2017.

1. When submitting your views please indicate whether you are responding on behalf of an organisation.
2. FSD is also interested in receiving general comments and feedback on the Proposals. Please feel free to respond to all, or some, of the questions.
3. Unless specifically requested otherwise, any responses received may be published either in part or in their entirety. Please mark your response clearly if you wish your response and name to be kept confidential. Confidential responses will be included in any summary of comments received.
4. The purpose of the consultation is to gather information, views and evidence which will allow an informed decision to be made regarding the Proposals. As in any consultation

exercise the responses received do not guarantee changes will be made in accordance with what has been proposed.